OLR RESEARCH REPORT

March 22, 2012 2012-R-0156

COMPETITIVE BIDDING IN MEDICARE

By: Hendrik DeBoer, Research Fellow

You asked for a brief explanation of competitive bidding in Medicare.

SUMMARY

For the vast majority of its covered services, Medicare currently uses an "administrative pricing" approach, in which the price of any service Medicare covers is calculated and set by the government. "Competitive bidding" is an alternative approach, in which health care providers bid for contracts to provide goods or services. Currently, Medicare uses competitive bidding on a limited basis for select medical equipment and devices. Evidence suggests that these limited experiments have been successful in lowering the price the government pays for these goods.

Recent health care proposals from both Democrats and Republicans have sought to expand the use of competitive bidding in Medicare. These range from small expansions of services that use competitive bidding to large overhauls of the entire Medicare system.

Those in favor of competitive bidding argue that increased competition would lower health care costs and shave billions of dollars off the federal deficit. Critics argue that the potential savings under such plans are unrealistic and would lead to reduced access for Medicare beneficiaries.

Sandra Norman-Eady, Director
Phone (860) 240-8400
FAX (860) 240-8881
http://www.cga.ct.gov/olr

Connecticut General Assembly
Office of Legislative Research

Room 5300
Legislative Office Building
Hartford, CT 06106-1591
Olr@cga.ct.gov

COMPETITIVE BIDDING IN MEDICARE

Standard Medicare Pricing

Medicare is a national social insurance program administered by the federal government that guarantees access to health insurance for most seniors and people with disabilities. Medicare is a single-payer health care system, where private health care providers furnish medical services to the covered group and most expenses are charged to and paid by the government.

The prices that Medicare pays to providers for these services are generally set by "administrative pricing." Under this system, Medicare determines the actual cost of any unit of service (such as a doctor visit, a hospital admission, an item of equipment from providers, or a monthly payment to health plans). This is done by calculating the costs based on analysis of the service and historical records of claims.

Current Competitive Bidding In Medicare

A second approach to setting prices is "competitive bidding." Under this system, the government creates a bidding arrangement among health care providers, who submit bids of the price at which they are willing to provide their services. The government contracts with the providers who submit the lowest bids.

Medicare has experimented with a competitive bidding program for contracts for certain medical equipment and supplies (called DMEPOS program). Under the program, DMEPOS suppliers compete to become Medicare contract suppliers by submitting bids to furnish certain items in competitive bidding areas, and the federal Medicare agency (the Centers for Medicare & Medicaid Services (CMS)) awards contracts to enough suppliers to meet beneficiary demand for the bid items. The new payment amounts resulting from the competition replace the former prices set through administrative pricing in these areas.

All contract suppliers must comply with Medicare enrollment rules, be licensed and accredited, and meet financial standards. According to CMS, the program sets more appropriate payment amounts for DMEPOS items while ensuring continued access to quality items and services, which will result in reduced beneficiary out-of-pocket expenses and savings to taxpayers and the Medicare program (https://www.cms.gov/DMEPOSCompetitiveBid).

The Government Accountability Office (GAO) reported in 2008 on the effectiveness of the DMEPOS competitive bidding program and determined that evidence suggests that "competition saved Medicare $7.5 million and saved beneficiaries $1.9 million—without significantly affecting beneficiary access." The GAO also warned, however, that "[b]ecause of concerns that competitive bidding may prompt suppliers to cut their costs by providing lower-quality items and curtailing services, ensuring quality and access through adequate oversight is critical for the success of the competitive bidding program" (http://www.gao.gov/assets/120/119966.pdf).

In 2011, CMS announced a continuation of the program, which they expect will save Medicare $28 billion over 10 years (http://www.aopanet.org/2011_CMS_PressRelease_Round2HCPCSCodes.pdf).

Proposals for Expanded Competitive Bidding in Medicare

Several recent health care reform proposals include an expanded use of competitive bidding in Medicare. For example, the House Republicans' recently unveiled budget proposal includes the creation of a health care "exchange" that would use competitive bidding. Private health care providers would send the government an estimate of the premiums for insurance plans with coverage at least as generous as the standard Medicare benefit package. The second-lowest of those "bids" would set the benchmark for how much money the government would pay to seniors for purchasing (1) health care from the exchange, (2) traditional Medicare, or (3) a more-costly coverage package. Seniors would be responsible for paying any difference between the benchmark amount and the cost of traditional Medicare or another plan. The plan would also eventually raise the standard minimum age of Medicare eligibility from 65 to 67.

The Republicans' plan for Medicare is similar to the health insurance exchanges that will launch under the Affordable Care Act in 2014 (but will not affect Medicare). The Obama administration has previously proposed competitive bidding for some types of Medicare coverage.

Pros and Cons

Proponents of competitive bidding believe such a system, by creating competition, will cause providers to offer prices closer to their own costs. This is founded in the belief that market pressures will lower costs and raise value. They point to the success of the DMEPOS program as evidence of the need to expand competitive bidding. The American Enterprise Institute, a conservative think tank, argues that a competitive bidding program similar to the one proposed in the House Republicans budget could save $339 billion over ten years (http://www.aei.org/outlook/health/healthcare-reform/competitive-bidding-can-help-solve-medicares-fiscal-crisis/).

Critics of competitive bidding argue that creating successful bidding programs that cover a larger population is challenging, and has proven difficult in past Medicare experiments. Patient groups have argued that competitive bidding could harm beneficiaries by curtailing access and choice to specific benefits. There is also concern that private insurance plans could structure a less-expensive benefit package in a way that would attract only the healthiest seniors, potentially leaving traditional Medicare with the sicker patients. Many members of Congress have opposed the expansion of competitive bidding attempts based on concern that it would hamper local businesses that supply Medicare products. Critics of the House Republican budget and similar reform plans argue that the claimed savings are unrealistic (http://www.washingtonpost.com/blogs/ezra-klein/post/what-paul-ryan-learned-from-obamacare/2012/03/20/gIQAtHIfPS_blog.html).

HD:km